No. 237

IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1943

R. K. JAPHA, SUING ON HIS OWN BEHALF AND ON BEHALF OF ALL OTHER OWNERS OF FIRST AND REFUNDING MORTGAGE GOLD BONDS, SERIES A, DUE JANUARY 1, 1951, OF CHICAGO, AURORA & ELGIN RAILROAD COMPANY,

Petitioner,

vs.

PUBLIC SERVICE COMPANY OF NORTHERN ILLINOIS, A CORPORATION, AND CITY NATIONAL BANK & TRUST COMPANY OF CHICAGO, A NATIONAL BANKING ASSOCIATION,

Respondents.

REPLY OF PUBLIC SERVICE COMPANY OF NORTHERN ILLINOIS, A CORPORATION, RESPONDENT, TO THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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To The Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

This respondent, Public Service Company of Northern Illinois, a corporation, respectfully submits this, its reply to the petition for writ of certiorari to review the decision and order of the United States Circuit Court of Appeals

for the Seventh Circuit in the above cause affirming the order of the District Court for the Northern District of Illinois, Eastern Division, which dismissed the petitioner's action against this respondent, Public Service Company of Northern Illinois.

STATEMENT.

The petitioner has given such an incomplete and misleading statement of facts that it would be difficult for this court to pass upon the application of the law involved without our amplifying the statement contained in the original petition.

This suit is brought upon an alleged violation of the terms of an instrument called a lease agreement between the respondent, Public Service Company of Northern Illinois, and the Chicago, Aurora & Elgin Railroad Company, which instrument is, in effect, a conditional sales contract of certain equipment and property, requiring annual payments of $185,000 for the first year and for each succeeding 29 years, a sum of $5,000 less than the annual amount payable for the year next preceding such a succeeding year, and that at the end of the 30 year period, all of the equipment and property shall become the property of the Public Service Company of Northern Illinois.

The agreement further provides that any replacements made by the Public Service Company of Northern Illinois shall be their property. The instrument contains no option on the part of either party but is an outright agreement to purchase, providing for prepayments over a period of 30 years, during which time the title remains in the seller until the final payment is made. The respondent, Public Service Company of Northern Illinois, has paid the annual

rental regularly to the Chicago, Aurora & Elgin Railroad Company until the appointment of a receiver for the Railroad Company, and since the appointment of the receiver, the rental has been regularly paid to the receiver. The Public Service Company of Northern Illinois has also paid all taxes and special assessments levied against the property, and complied with all the provisions of the agreement, and has indicated its intention to continue to comply with all the terms and conditions of the agreement.

The statement of the petitioner does not advise this court that the District Court, in which his complaint was filed, was the same court in which the receivership proceedings of the Chicago, Aurora & Elgin Railroad Company have been pending since 1932. That the District Court took judicial notice of the said receivership case and the foreclosure suit brought in the same court by the Trustee securing the bonds of the plaintiff, which two matters have been consolidated as cause Nos. 15893 and 12125 in the District Court of the United States for the Northern District of Illinois, Eastern Division.

Petitioner's statement fails to advise the court that the petitioner stipulated in the Circuit Court of Appeals for the Seventh Circuit that the said Circuit Court of Appeals may take judicial notice of the said consolidated cause (R. 49-50). Therefore, the facts upon which the trial court based its finding and judgment, and upon which the United States Circuit Court of Appeals for the Seventh Circuit considered the case upon appeal, are not limited to the allegations of the complaint but include the record of the consolidated cause No. 15893 and No. 12125 pending in the District Court of the United States for the Northern District of Illinois, Eastern Division, as brought up to the Circuit Court of Appeals by photostatic copies of said record and incorporated in the printed record by reference. In the said consolidated cause, the court appointed

highly competent engineers to study and report with reference to the agreement herein sued upon, and after a thorough study by said engineers and due consideration by the receivers, the District Court entered an order authorizing and instructing the receivers to affirm and adopt the agreement herein sued upon (P.R.). The District Court recognized the agreement with the Public Service Company of Northern Illinois as a long term purchase agreement and, at various times, ordered insurance losses with respect to said property, paid over by the receivers to the respondent, Public Service Company of Northern Illinois (P.R., order dated February 26, 1935; P.R., order dated October 26, 1937; P.R., order dated December 10, 1937).

On December 16, 1937, the Trustee, under the mortgage securing the bonds of the petitioner herein, filed its petition in the District Court of the United States for the Northern District of Illinois, Eastern Division, for leave to file its Bill of Complaint for foreclosure (P.R.), which was allowed, and the foreclosure proceeding is pending in the consolidated cause of which the District Court and the Circuit Court of Appeals for the Seventh Circuit took judicial notice in its finding and judgment to dismiss from the petitioner's cause of action, the respondent herein, Public Service Company of Northern Illinois, in this proceeding.

The agreement herein sued upon was entered into more than 16 years prior to the filing of the complaint of the petitioner herein, at which time approximately twenty-five per cent of the property involved in said agreement was obsolete, and none of it was new (P.R.). That all of the property covered by the agreement herein sued upon, on which waste is charged by the petitioner, is personalty, over 16 years old, and some of it as much as 40 years old and fully depreciated (P.R.).

JURISDICTION OF THIS COURT.

This court is without jurisdiction to allow a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit in this matter under rule 38, paragraph 5 of this court or under Section 240-a of the Judicial Code, as amended by the Act of February 13, 1925 (28 U.S.C.A., Sec. 347-a), in that, the decision of the United States Circuit Court of Appeals for the Seventh Circuit is not in conflict with any local law of Illinois, decisions of other Circuit Courts of Appeal or any decisions of this court in any respect.

SUMMARY OF LAW RELIED ON.

I.

To give a third party an action on a promise there must be an intent by the promisee to secure a direct benefit to the third party and also some privity between the promisee and the third party, and some obligation of the promisee to the third party which would give him a legal or equitable claim to the benefit of the promisor or an equivalent from the promisee.

Federal Surety Company v. *Minneapolis Steel and Machinery Company,* 17 Fed. (2d Series) p. 243.

Louisville Trust Co. v. *City of Cincinnati,* 76 Fed. 296 (22 C. C. A. 334).

German Alliance Insurance Co. v. *Home Water Supply Co.,* 226 U. S. 220, 227.

II.

The only remedy in equity which the plaintiff or the Trustee under the mortgage may maintain would be for an injunction to restrain anticipated waste or anticipated impairment of the security pledged under the mortgage but cannot sue for waste which has already accrued.

The Ohio Coal Co. v. *N. P. Daughetee,* 240 Ill. 361-368.

Merchants Union Trust Company, et al. v. *New Philadelphia Graphite Company, et al.,* 83 Atl. 520; 10 Delaware Ch. 18.

41 Corpus Juris 649.

(A) The agreement of January 15, 1925, being an installment purchase agreement, neither the Trustee under the mortgage nor the plaintiff can sue for waste.

John H. Fifer v. *Melissa E. Allen, et al.,* 228 Ill. 507-521.

John W. Keogh v. *Robert B. Peck,* 316 Ill. 318-326.

ARGUMENT.

I.

To give a third party an action on a promise there must be an intent by the promisee to secure a direct benefit to the third party and also some privity between the promisee and the third party, and some obligation of the promisee to the third party which would give him a legal or equitable claim to the benefit of the promisor or an equivalent from the promisee.

This is a third party action where the holder of a mortgage bond issued by one party to an agreement is suing the other party to the agreement, and in order to bring this suit, the petitioner must show that the agreement entered into between the parties and herein sued upon, or at least one provision thereof, is for the direct benefit of the petitioner or mortgagee who is not a party to the agreement. The law with respect to the right of third party actions is well defined in the Illinois cases and, unless the facts alleged in the complaint clearly show a direct benefit to the petitioner was intended by the parties to the agreement, the petitioner's action fails.

The only reference to the security holders in the entire agreement of twenty-nine pages is that stated in the excerpt in the footnote of petitioner's petition on page 8. That single reference to the rights of security holders is to say that if the respondent should discontinue the use of, and dispose of any equipment no longer required, it should have in mind, and be bound by, the prior rights of the security holders.

There is no allegation in the complaint of the petitioner that the respondent, Public Service Company of Northern Illinois, has disposed of any equipment and, therefore, petitioner has no right to attempt to invoke that single reference to the rights of security holders in said agreement.

The complaint of the petitioner is also fatal because he does not allege that the security has depreciated so as to impair the security of the mortgage (41 C. J. 649). The respondent takes no issue with the petitioner on the law cited in support of the principle of third party actions, but the facts do not come within that line of cases.

In the first place, it must be determined whether the agreement entered into between the Railroad Company and the respondent, Public Service Company of Northern Illinois, herein sued upon, is for the direct benefit of the petitioner or mortgagee. Certainly the respondent did not assume any of the obligations under the mortgage. While under the agreement, the respondent is to substitute new equipment at its own expense, the agreement also provides that such new equipment is to be the property of the respondent and that the Railroad Company has no rights of reversion, or any other rights therein. Therefore, the installation and substitution of new equipment and machinery can in no way be for the benefit of the petitioner or mortgagee.

Even as to disposing of abandoned equipment, there is no provision for the benefit of the petitioner or mortgagee, either direct or incidental, as it provides only that, in case of disposing of any equipment no longer required, the respondent shall have in mind and be bound by the prior rights of security holders. However, there being no allegation in the complaint that the respondent, Public Service Company of Northern Illinois, has disposed of

any machinery or equipment, it is not necessary to determine whether that provision of the agreement is for the direct benefit, incidental benefit or any benefit of the petitioner or mortgagee. In all the cases cited by petitioner in paragraph 1 of his argument involving third party actions, they are all tort cases except the case of *Minneapolis Trust Co.* v. *Verhulst,* 74 Ill. App. 350 (petitioner's Brief, page 6). This is a foreclosure suit wherein the lessee was joined and the relief prayed against the lessee was for waste. In that case (page 356), the court said:

> "An action at law by the mortgagee will not lie for the commission of waste."

The court points out that the proper remedy against the lessee is for injunction to stay the commission of waste.

The case of *Nelson* v. *Pinegar,* 30 Ill. 473, and *Citizens National Bank* v. *Joseph Keisl & Sons,* 378 Ill. 428 (Pet. p. 6) are both cases in tort and could not support a complaint brought upon a contract.

The case of *Hummer* v. *R. C. Hoffman Construction Company,* 63 Fed. (2d) 372-374, cited by counsel in his petition (page 6) is a suit in law (case) for trespass, and neither privity of contract nor estate is involved and accordingly not discussed. It was, in fact, an action for waste in tort for trespass *quare clausum fergit,* against a stranger.

The case of *Delano* v. *Smith,* 206 Mass. 365, cited by counsel in his petition (page 6) is likewise a tort case.

The cases cited by counsel in paragraph 2 of his argument (page 7) are all cases where contracts are made for the direct benefit of the third party suing and so intended at the time of making the contract and we take no issue with counsel as to the law of Illinois with respect to such line of cases, but deny that there are any allegations in the complaint, or any facts considered by the trial

court or the Circuit Court of Appeals in consolidated causes of which they took judicial notice that would bring the petitioner within the rule of these cases.

Likewise counsel, in paragraph 3 of his petition (page 8), assumes that the decisions of both the trial court and the Circuit Court of Appeals were based upon his incapacity to sue as a holder of a bond because of the pendency of the foreclosure proceeding. We take no issue with counsel on the law as defined in the line of cases cited by counsel under paragraph 3 of his argument (page 8), but like paragraph 2 of his argument, is based upon a false premise. The point is not that the petitioner is barred from bringing an action because of the pendency of the foreclosure proceeding and the receivership proceeding, but the point is that the lower court took judicial notice of the proceedings in the foreclosure case and the receivership case, and this is not only within their right (*Louisville Trust Co.* v. *City of Cincinnati*, 76 F. 296, 22 C.C.A. 334) but was stipulated to in the Circuit Court of Appeals by the petitioner (P.R.).

The courts have frequently interpreted provisions of agreements to determine whether they are for the direct benefit of a third person not a party thereto, and in *Federal Surety Company* v. *Minneapolis Steel and Machinery Company*, 17 Fed. (2d Series) 243-244, the court said:

> "The right of the third person to maintain an action on the contract in his own name is in a sense remedial, but the right to sue depends upon the substantive right of such third party under the contract. It depends upon whether the obligation of the contract creates a direct liability from the promisor to the third person in his own right and not in the right of another. It involves an interpretation of the contract."

Again, in the same case, on page 243, the court points out quotes from a decision of this court, *German Alliance Insurance Co.* v. *Home Water Supply Co.*, 226 U. S. 220, 227:

> "Before a stranger can avail himself of the exceptional privilege of suing for a breach of an agreement, to which he is not a party, he must at least show that it was intended for his direct benefit."

II.

The only remedy in equity which the plaintiff or the Trustee under the mortgage may maintain would be for an injunction to restrain anticipated waste or anticipated impairment of the security pledged under the mortgage but cannot sue for waste which has already accrued.

The court should not lose sight of the important fact that the only interest of the petitioner in the property involved in the agreement between the Railroad Company and the respondent, Public Service Company of Northern Illinois, is one in which the defendant has, at most, a contingent interest, contingent upon the default of the Public Service Company of Northern Illinois to make the stipulated payments, and contingent upon the recovery of the property by the mortgagor. In the *Ohio Coal Co.* v. *N. P. Daughetee*, 240 Ill. 361-368, the court said:

> "A contingent remainder-man has no certain estate in the land, and therefore no standing to maintain an action at law for past waste or a bill for an account thereof; but though his claim depends upon a contingent event, he may maintain a bill against a life tenant to enjoin future waste."

In the case of *Merchants Union Trust Company* v. *New Philadelphia Graphite Company* (83 Atl. 520; 10 Delaware

Ch. 18) in which case the plaintiff was the Trustee of the mortgage made by the owner of the mine, the bonds were in default and a foreclosure suit had been filed. The relief sought was for the rents and royalties due under the lease and also damages for waste and depreciation of the security pledged under the mortgage. The lease had been entered into subsequent to the mortgage, as in the case at bar, and no provision was made in the mortgage for the Trustee to have any right of action against the lessee or third persons contracting with the mortgagor. All of the facts and circumstances are identical to the case at bar. In that case the court said:

> "It is unnecessary to consider whether any waste, within the meaning of the law, was committed by the lessees in using or working the land in a mining lease and for the purpose for which it was leased, because it is clear that the complainants are not entitled to recover from the lessees, damages for any waste that may have been committed. There is no doubt that the mortgagee for the protection of his security was entitled, as against the mortgagor, to an injunction to restrain any waste which put in peril his security, but he cannot recover from the lessees or their assigns, damages for waste they may have committed."

In 41 Corpus Juris 649, it re-states the law as set forth above but adds that where a mortgagor in possession or his assigns or anyone acting under their authority or direction threatens to commit waste upon the mortgaged premises, as by cutting timber, removing buildings, or taking away machinery or other fixtures to such an extent as will impair the security of the mortgage, equity will grant the latter a Writ of Injunction to restrain the anticipatory injury.

(A) The agreement of January 15, 1925, being an installment purchase agreement, neither the Trustee under the mortgage nor the plaintiff can sue for waste.

An examination of the lease agreement (Photostatic record) discloses the fact that while it is called a lease agreement, the defendant, Public Service Company of Northern Illinois was to become the sole owner of the property after 30 years of payments as provided under the agreement and any new equipment which constituted a replacement was to be the absolute property of the defendant, Public Service Company. Therefore, it is not even an option agreement to purchase but an absolute agreement to purchase over a 30 year period. In the case of *Keogh* v. *Peck*, 316 Ill. 318-326, the court says:

> "Where, however, in a lease a tenant is given an option to purchase the premises at any time before the expiration of the lease, while the tenant until the privilege of purchase is offered remains a mere tenant, subject to the same obligations as other tenants and answerable for any waste committed by him, still his liability to a suit for waste is suspended until it is known whether or not he will avail himself of his privilege. The fact that the estate will ever revert to the landlord is not fixed and certain and while the legal right to exercise the option remains, there can during such term be no act of waste committed which the tenant cannot avoid by the exercise of his right to purchase."

It is therefore apparent in this case where there is no option to purchase but an agreement to purchase over a 30 year period so that neither the mortgagor nor the bondholders secured by said mortgage have the right to sue for waste.

In the case of *Fifer* v. *Allen*, 228 Ill. 507-521, the court there said:

> "A court of chancery will interfere to enjoin equitable waste by the owner of a base or determinable fee only when the contingency which is to determine the estate is reasonably certain to happen and the waste is of a character to charge the owner with wanton and unconscientious abuse of his rights."

CONCLUSION.

Wherefore, it is respectfully submitted that the writ of certiorari to review the decision herein of the Circuit Court of Appeals for the Seventh Circuit be denied.

CHARLES WEINFELD AND
HOWARD D. MOSES,
Counsel for Public Service Company of Northern Illinois, Respondent.